

Tax Reform in Other States

A Summary

At the request of the Committee, tax reform efforts in several other states were researched and analyzed to determine common factors that prompted the tax reform efforts, and whether the reform efforts were successful. The following states are included in this analysis:

Connecticut
Florida
Illinois
Michigan
Minnesota
New Hampshire
New Jersey
Oklahoma
Tennessee

What prompted the tax reform efforts in other states?

In most of the above states, efforts for tax reform were in response to one of two factors:

- Taxpayer perceptions of high tax burdens; or
- Immediate or future budget shortfalls.

In the last decade, several states have responded to the public perception of high tax burdens by undertaking studies to evaluate the relative tax burdens of taxpayers in the state, and developing alternative proposals to reduce the burdens. For example, tax reform efforts in New Hampshire, Michigan, and Minnesota were prompted in part by taxpayers' perceptions that the property tax burdens were too high and that the taxes themselves were too complex.

Also in the last decade, many states have experienced a budget shortfall or were anticipating that revenues would fall short of budget needs in future years. Tennessee's tax reform study and legislation was driven by the \$900 million shortfall in the Governor's proposed budget in 1998. While Connecticut completed its study of the state tax structure in 1990 in a period of relative economic prosperity, the subsequent enactment of a personal income tax (one of the analyzed alternatives) occurred in a period of severe budget crisis.

Were the reform efforts successful?

The majority of states listed above have undertaken their tax reform efforts in response to a major crisis: after taxpayer perceptions have reached an all-time low, or when the state is in the throes of a budget deficit.

Although one could ascribe many reasons for the failure of various tax reform efforts in the remaining states, the common sense response is that the unsuccessful states were not

experiencing the same level of state crisis, either real or perceived, to add urgency to the desire for tax reform. Oklahoma, for example, undertook its tax study to determine the economic effects of a hypothetical tax reform package that never materialized in legislation.

The list below describes briefly each state's reform efforts and the results:

- **Connecticut** – Study recommended business tax reform, broadening the sales tax base, and possible implementation of a personal income tax. Successful implementation of a state personal income tax and eventual incremental business tax reform (rate reductions and credits).
- **Illinois** – Study recommended various incremental reforms to state income taxes, property tax, and sales taxes. Incremental sales tax reforms successful; namely reduced sales tax on food and drugs, and inclusion of some services in the tax base.
- **Florida** – Still conducting tax study, attention focused on state tax exemptions.
- **Michigan** – No formal study conducted. Legislation virtually eliminated local property taxes and subsequent legislation was approved by voters to increase the state sales tax as an alternative funding source. Legislation provided for eventual repeal of state single business tax, no alternative tax imposed.
- **Minnesota** – Study recommended significant reforms to property, sales, and income taxes. Successful implementation of property tax reform including reducing classifications of property and tax rates and elimination of state property tax levy.
- **New Hampshire** – Court decision struck down local property tax system. Legislation imposed a statewide property tax as a replacement revenue source. Study group convened to study alternative tax sources and analyzed personal income taxes, sales taxes, value-added taxes, and additional property tax reform. No further tax reform implemented.
- **New Jersey** – Study recommended reforms to sharing of service burdens by state and local government to reduce heavy reliance on local property taxes. Study also recommended budget and administrative reforms. Successful implementation of rainy day fund for administrative reform but little reduction in local property tax burden.
- **Oklahoma** – Governor and Legislative leaders formed Study Committee with the goal of finding a revenue-neutral way to eliminate the state personal income tax, and provide a sales tax exemption for groceries. Study developed five options, none of which were implemented.
- **Tennessee** – Legislation significantly expanded the state business tax. Subsequent legislation convened a study committee to evaluate the state tax system, focusing attention on tax exemptions. No further tax reform was successful.

Connecticut Task Force on State Tax Revenue – Final Report

In 1989, Public Act 89-251 was passed by the Connecticut General Assembly to set up a Task Force on State Tax Revenue. The Task Force started its proceedings in September of 1989 and concluded in December 1990.

The Task Force generated a three-part final report, evaluating three major revenue sources: the state's currently imposed business tax, retail sales tax, and a proposed personal income tax.

Business Taxes:

The Task Force was instructed to focus its analysis on the following areas:

- Effects of the business tax on business investment;
- Other states' business tax policy compared with Connecticut;
- Effects of the business tax on different size firms in different industries;
- Effects of the business tax on corporations versus other forms of businesses (such as partnerships and proprietorships);
- How different tax bases would impact state revenues and taxpayers; and
- Effects of federal tax policy reform on the corporate income tax base.

The Task Force made various recommendations in response to the analysis of business tax issues. The following recommendations address the major business tax issues raised in the report:

- Expand the definition of taxable income;
- Create a new apportionment formula for multi-state income;
- Implement "throwback" or "throwout" rules; and
- Reduce the overall tax burden on businesses.

In addition to the above business tax recommendations, the Task Force commissioned a consulting firm to develop two statistical tax models, which would be installed on state computers. The models would enable the testing of a wide range of corporate tax scenarios and trends and their impact on state and local taxes on hypothetical businesses in a variety of the major industries in the state.

Sales and Use Taxes:

In the sales and use tax area, the Task Force was charged with evaluating the following issues:

- The role of the sales tax in the Connecticut tax mix;
- The tax rate;
- Additional changes in the tax base;
- Stability of the tax base;
- Implications of tax policy for economic development;
- A level playing field;
- Local taxes;
- Administrative issues;

- Equity of the sales tax; and
- Exemptions from the tax base, e.g. services not subject to sales tax.

The Task Force considered the following principles in its evaluation of sales and use taxes:

- Competitiveness;
- Cascading and uniformity;
- Distributional effects; and
- Tax exporting.

The Task Force developed four different scenarios for restructuring the sales tax system. Each scenario was presented with both a revenue-neutral and revenue-enhancing variation (an additional \$500 million per year). The four options included:

1. A complete broadening of the tax base at the consumer level without changing business tax rates.
2. Eliminate all business taxes. Completely broaden the tax base at the consumer level.
3. Add all services to the tax base but exempt business purchases of services. Businesses would pay sales and use tax on only 75 percent of their equipment purchases.
4. Broaden the tax base by including consumer purchases of food and clothing.

Personal Income Tax:

The objective of the personal income tax component of the overall Tax Task Force mandate was to analyze alternatives to personal income tax with a focus on:

- Comparison of Connecticut's tax system with other states (neighbors New York, New Jersey and Rhode Island);
- Stability of current revenue sources; and
- Impacts of the current tax structure on the fiscal and economic environment.

Due to the fact that Connecticut does not currently impose a personal income tax, the Task Force commissioned a consulting firm to develop a simulation model to analyze the effects of various personal income tax options and their tax burden patterns. The following are the results of a tax incidence analysis using this model.

Comparison with NY, NJ, and RI:

- Current Connecticut taxes are more regressive than in the three comparison states;
- For one scenario of the analysis, all four states were found to have very regressive taxes. The implication is that a large proportion of sales taxes on business purchases, business property taxes and corporate income taxes are shifted to consumers and employees;
- Under another scenario, Connecticut taxes were found to be only moderately regressive for incomes over \$30,000;
- A major source of regressivity is the sales tax; and
- Capital gains, interest and dividends are steeply progressive in all four states.

Stability of Tax Sources:

- Sales and use taxes, corporate income taxes, capital gains taxes, and interest and dividend taxes were found to be relatively unstable;

- Sales taxes were found to be volatile due to exemption of many consumer expenditures and the inclusion of cyclical durable goods purchases in the tax base;
- There is a need to broaden the tax base to include a wider range of consumer expenditures;
- The sales tax is less volatile compared to corporate income and capital gains, interest and dividends taxes; and
- A broad-based personal income tax would be more stable than existing main sources of tax revenues. The stability of a broad-based sales tax would be similar to a broad-based personal income tax.

Impacts of Current Tax Structure on the Fiscal and Economic Environments:

- Since 1984 there have been more frequent tax changes in Connecticut compared to the three comparison states;
- Due to lack of a broad-based personal income tax, business taxes have been increased to meet state revenue needs; and
- There is a lack of conclusive evidence for quantifying the economic impact of instituting a personal income tax in Connecticut relative to other alternative fiscal policies.

The Task Force developed the following recommendations regarding personal income taxes. The group did not express a position for or against imposing a personal income tax, but developed recommendations for further study if the state decided to explore personal income tax alternatives. The recommendations for future consideration include:

- Designing different tax base definitions and rate structures that specifically target a revenue group;
- Determine how and at what point to conform to the federal code;
- Choose between having a flat tax rate or a graduated tax rate;
- Alternative tax structures that are designed to be revenue neutral;
- Necessity for implementing a tax withholding system and developing easily accessible taxpayer services to administer a personal income tax efficiently; and
- Necessity for modernization of administrative information systems to implement a personal income tax.

In 1991, the Connecticut Legislature enacted a state personal income tax. After the completion of the Task Force report, the state budget experienced a shortfall of approximately \$800 million in 1990. Despite significant disagreements about the structure and advisability of a personal income tax, the budget crisis was severe and immediate enough to convince the Legislature to enact, and the Governor to sign, Public Act 91-3, a budget bill that also implemented a personal income tax.

Implementation of the income tax was complicated, since the budget bill imposing the tax required a one-year phase in tax rate of 1.5 percent, after which the rate increased to 4.5 percent. However, in recent years, the income tax rate has been reduced and personal exemptions have been increased. In addition, the state's corporate business tax rate has been reduced, and more corporate business tax credits have been enacted (for example, credits for fixed and human capital investment).

Florida State Tax Reform Task Force – Interim Report

In June, 2000, Governor Bush signed legislation creating a Task Force to examine the state's tax structure and make recommendations on how the state's tax structure could be improved to ensure a stable revenue base that is adequate to fund the needs of the state. The final recommendations are due to the Governor and the Legislature by February 1, 2002.

The authorizing legislation directed the Task Force to consider principles of sound tax policy such as effectiveness, efficiency, and equity as the group evaluated the state's tax system. The group was also directed to consider the following factors in their analysis:

- Other states' tax treatment of tax issues;
- Florida's tax base, rates, and tax burdens;
- Justification of tax exemptions; and
- Alternative tax sources.

The Task Force was also directed to provide an interim report by February 1, 2001, outlining the progress of the group to date.

The Task Force and its subcommittees have met several times beginning in August, 2000. To date, most meetings have consisted of various presentations by economists, tax policy experts, legislative committee staff, and others. The Task Force has been presented with more than 20 topics of discussion on multiple issues such as the state's tax structure, discussions of individual taxes, current national tax policy projects, and more. Following is a listing of the subjects the presentation have covered:

- State Tax Reform Task Force Objectives
- Florida's Tax Structure
- Commerce and the Internet
- Florida State Taxes
- General Tax Administration
- Estate Tax
- Major Changes in Tax Policy
- Sales Tax Exemptions: A Tool for Lowering the Sales Tax Rate in Florida
- Florida's Revenues, Expenditures, and the Constitutional Revenue Limitation Relationship of Taxes and Economic Development
- Streamlined Sales Tax Project
- Crossroads
- Florida's 1987 Sales Tax Experience
- Taxes and Florida Business Climate
- Municipal Funding
- County Funding
- School District Funding
- Review of Tax Administration/Simplification Issues

- Florida's Tax Structure: An Overview
- State Tax Reform Task Force
- County Tax Structure Responses to Questions From the State Tax Reform Task Force

The Task Force has not released any information on what issues it is considering for the final report or the alternative tax sources it may be developing. The next meeting of the Task Force is scheduled for December 12, 2001, and the agenda is devoted to public comment and a discussion of the final report.

Florida State Tax Reform Task Force – Interim Report, February 1, 2001

Illinois Tax Reform Commission – final report

In 1982, Governor Thompson created a state Tax Reform Commission to examine the tax structure of Illinois and make recommendations which would create the lowest, most equitable tax burden possible while still meeting budgetary needs.

The Commission formed five subcommittees to study specific issues and taxes. The groups analyzed the following taxes: business taxes, individual income taxes, property tax, occupation and use taxes, and excise and other consumption taxes. In its final report, the Commission summarized the findings for each tax and outlined possible modifications which would address the identified areas of concern.

Governor Thompson asked the Commission to examine the major state taxes in relation to general tax principles as guidelines: simplicity, neutrality / efficiency, elasticity, equity, and reliance. In the final analysis, the Commission drew the following conclusions regarding the state's current tax system:

- Corporate income tax: simple and neutral, although revenues tend to vary with business cycles.
- Individual income tax: flat rate tax is simple and neutral and a large revenue producer for Illinois. Personal exemptions make the tax progressive.
- Property tax: complex and regressive but neutral. Illinois relies heavily on property tax revenues.
- Occupation and use taxes: this version of a “sales tax” is not simple or uniform between state and local governments. Taxation of food and drugs is regressive.
- Tobacco, fuel and utility taxes: simple to administer but not as neutral as the above taxes.

The Commission then developed alternative recommendations for improving the tax system. The recommendations included:

Corporate income tax:

- Reform apportionment calculation.
- Join a multi-state organization to harmonize state tax laws.

Individual income tax:

- Increase personal exemptions and increase the tax rate.
- Include military pay for residents in gross income.

Property tax:

- Require full market valuation of property on tax bills.
- Allow installment payments of property taxes.
- Enact sunset legislation for exemptions.
- Reform school financing system using more state revenues rather than local.

Occupation and use taxes:

- Require local governments to use the same sales tax base as the state.
- Exempt food and drugs from taxation.
- Broaden the sales tax base to services.

Excise and other consumption taxes:

- Apply the tobacco tax to all tobacco products.
- Change the fuel tax to a variable rate tax.
- Impose higher fuel taxes on heavy trucks.

Few of the Commission's recommendations were implemented. Perhaps the most significant change in Illinois tax administration was the legislation in 1990 that transferred administration of local governments' sales taxes to the state Department of Revenue, thereby addressing at least in part the recommendation for uniformity of the tax base among taxing jurisdictions. In addition, the sales tax on food and drugs was eventually reduced from the general state rate of 6.25 percent to 1 percent, and completely exempted from local sales tax. In recent years legislation was enacted to add many services to the sales tax base (primarily services in which tangible personal property is transferred as an incident of the service).

Tax Reform Commission – final report - December, 1982

Michigan Property Tax Reform and Single Business Tax Repeal

In the last ten years, Michigan has undergone significant tax reform that included major revisions to the school financing system and business taxes in the state. None of these reforms were prompted by an “official” tax reform study or commission.

Property Tax Reform

In August 1993, Governor Engler signed legislation that virtually eliminated local property taxes as a source for school funding. High reliance on local property tax revenues for school financing and growing tax burdens for taxpayers prompted several efforts for tax reform in the 1970’s and 80’s, which were finally successful in 1993. The tax reform legislation did not contain an alternative funding mechanism to fill the \$7 billion hole this legislation caused in the school funding system.

In December 1993, the Legislature adopted a bill that gave Michigan voters the choice between two tax reform and funding options. In March 1994, the voters approved a plan to raise necessary school revenues through an increase in the state sales tax, voting down the alternative funding option of an increase in the state personal income tax. The approved ballot measure contained additional tax modifications, such as:

- Two percentage point increase in the state sales tax;
- 0.2 percentage point reduction in the state income tax;
- Threefold increase in the state cigarette tax (to \$0.75 per pack);
- Net reduction in property tax rates;
- Constitutional cap on property tax assessment increases; and
- Other tax modifications.

Single Business Tax Repeal

In 1999, Governor Engler signed into law a bill that provided tax relief for businesses through the gradual repeal of the state’s Single Business Tax (SBT). Public Act 115 of 1999 allowed for a 23-year phase-out of the tax by reducing the tax rate by one-tenth of one percent each year (the rate was 2.3 percent in 1999). However, the rate reduction would be halted any year in which the state’s Budget Stabilization Fund (BSF) held a balance of \$250 million or less. The legislation did not include a replacement tax to offset the reduced revenues to the state.

The SBT is a value-added tax based on several factors of business activity (profits, compensation costs, interest paid, and depreciation). It was enacted in 1975 as a single replacement tax for several previous state business taxes. The SBT replaced the corporate income tax, a local tax on business inventory, the corporate franchise tax, and several other smaller taxes. The SBT was enacted in a period of fiscal crisis in Michigan, with the hopes that the single tax would provide a less complex, more stable revenue stream for the state.

Since the enactment of the SBT in 1975 the tax has been amended many times. Critics of the SBT argued that the amendments contradicted the original goal of the tax by narrowing the tax base and providing special tax treatment for businesses in different circumstances. Critics also argued that due to the increased complexity of the SBT, it is susceptible to costly and complex litigation.

In response to these concerns, Governor Engler proposed the legislation to phase out the tax. The gradual phase-out was intended to strike a balance between protecting the state budget from the shock of instant repeal and providing business taxpayer the certainty of rate reductions and tax relief.

Critics of the legislative proposal to repeal the SBT voiced the concern that doing away with this tax would effectively eliminate state taxes on business. Although the repeal legislation did not include a replacement business tax, proponents of the bill pointed out that businesses would continue to pay real and personal property taxes as well as sales and use taxes.

Since enactment of the SBT repeal legislation, rate reductions have commenced. On September 30, 2000, the BSF reported a balance of \$1.26 billion, well above the \$250 million threshold for allowing annual rate reductions. The effective tax rate as of December, 2001 will be 2.0 percent (reduced from 2.3 percent).

Proposal A: A Retrospective – Michigan Department of Treasury, August, 1998
House Bill 4745 – House Legislative Analysis, Michigan Legislature 1999

Minnesota Property Tax Reform

In 1999, Governor Ventura set in motion an initiative for statewide tax reform. The proposal called for three steps in the reform process: assessment, design, and implementation. The Governor's administration charged the Department of Revenue with coordinating the tax reform process, focusing attention on the state property tax system.

Assessment

Gathering public input was the primary charge in the assessment phase of the tax reform initiative. A local research organization convened a Citizens' Jury, a randomly selected panel of state citizens who heard public testimony on the state's tax structure and developed recommendations for property tax reform. In August of 1999, the Jury released their report on their recommendations for tax reform. Following is a summary of the recommendations:

What role should the property tax play in financing local government?

- Less reliance on property tax across the board;
- Minimal changes in local sales taxes;
- No new local income tax;
- More state aid in school funding;
- More reliance on fees and charges;
- No unfunded mandates; and
- Direct relationship between fees and charges and the services provided.

What should be done to improve the property tax system?

- Simplify classes of property;
- Review tax credits for continued validity, repeal out-dated credits;
- No unfunded mandates;
- Allow counties to set own classifications and rates;
- Conduct cost of collection study for property tax; and
- Other recommendations on administration and simplification of the property tax.

Design

The design phase commenced in Spring, 2000. In developing specific recommendations to reform the tax system, several tax policy teams were formed to discuss different taxes. Each team started with the principles the citizens of the state had identified as important: fairness, simplicity, predictability, and competitiveness. Each team also developed possible options for reform proposals. A sample of recommendations follows:

- *Property tax* – Make the tax more “local”. Target state aid to shared state and local services. Rely more on targeted tax relief options. Eliminate arbitrary classifications of property.
- *Sales tax* – Create a “streamlined” system to simplify collection duties for retailers. Coordinate tax policy with neighboring states on certain goods and services.

- *Income tax* – Use the federal Adjusted Gross Income standard to keep the income tax progressive. Keep the income tax “marriage neutral.” Simplify the tax form.

Implementation

The various tax reform proposals were packaged and presented to Governor Ventura, who had legislation introduced in the 2001 legislative session to implement a broad package of tax reform plans. Senate File (SF) 473 included provisions for reforms to the state income tax, sales tax, property tax, corporate franchise tax, gambling and other special taxes, petroleum tax, minerals taxes, and tax administration. However, a legislative stalemate prevented action on the bill.

In May of 2001, Governor Ventura developed and presented a compromise tax reform proposal and called a special legislative session to deliberate the new ideas. The Governor’s proposal made significant revisions to the state and local property tax system aimed at providing substantial relief to property taxpayers.

In June of 2001, Governor Ventura signed the final version of tax reform legislation. House File (HF) 1 provided over \$900 million of property tax relief, various education finance reforms, and approximately \$850 million of sales tax relief in the form a sales tax rebate to taxpayers. Specific tax reform provisions in HF 1 included:

- Elimination of the state general education property tax levy;
- Compression of class rates within and across property classes;
- A new statewide property tax levy on business and seasonal recreational property. Revenues are dedicated to education funding;
- Exemption for farms and forests from local school levies and the new statewide levy;
- Average property tax reductions for all classes of property, ranging from a 23 percent reduction for homesteads to a 10 percent reduction for businesses;
- Expanded property tax refund program by increasing the maximum refund amount and expanding eligibility; and
- Average sales tax rebate of \$232 to each taxpayer that had income tax liability in the state.

Citizens Jury Report on Minnesota Property Tax Reform – August 1999

A Tax System that Makes Sense for Minnesota – Volume I, What We’ve Heard – May 2000

A Tax System that Makes Sense for Minnesota – Volume II, Design Guide for Tax Reform – September 2000

Governor’s Compromise Budget Proposal – May 25, 2001

Senate File 473, introduced 2001 legislative session

Chapter 5, Laws of 2001 First Special Session (House File 1)

New Hampshire New Hampshire Commission on Education Funding

In 1997, the New Hampshire Supreme Court, in the Claremont I decision, struck down the state's public school financing system and created an \$825 million budget shortfall.

Prior to the court decision, the school financing system depended on locally assessed property taxes as a source of revenue. The court reasoned that the tax system imposed an unreasonable and disproportionate burden on taxpayers. The New Hampshire Legislature responded in 1999 by enacting Chapter 17, Laws of 1999, an omnibus tax reform bill which imposed:

- Statewide property tax amendments, phased in over a period of five years for certain taxpayers;
- Utility property tax provisions;
- Real estate transfer taxes; and
- Other revenue sources.

This legislation was also challenged and struck down by the New Hampshire Supreme Court in 1999 in the Claremont II decision. Although the Legislature intended the phase-in provisions of the property tax amendments to provide tax relief to certain taxpayers that would be adversely affected by the new legislation, the court found the phase-in provisions to be unconstitutional. The court reasoned that since the phase-in period only took effect for certain taxpayers whose property taxes would rise substantially in the first few years of implementation, the legislation did not treat taxpayers proportionally and was therefore unconstitutional. The court made no recommendations about alternative funding sources, indicating instead that the development and choice of funding options was properly a legislative responsibility.

In response to the court's decision, the Legislature reenacted the property tax funding measure in Chapter 338, Laws of 1999. The bill removed the unconstitutional phase-in provision, providing tax relief to low and moderate income taxpayers in the form of a rebate of the increase in property taxes.

In April of 2000, Governor Jeanne Shaheen issued an Executive Order establishing a Commission to study various school funding options in response to the continuing budget shortfall. The Commission was directed to study additional alternative funding options and report to the state legislature. The group was composed of business and economics experts and was directed to evaluate potential funding alternatives and their effects on the state economy in general and certain types of taxpayers.

In their analysis, the Commission evaluated the alternatives according to the principles of equity, adequacy, competitiveness, exportability, neutrality, and simplicity. The specific tax alternatives included:

- Personal income taxes;
- Retail sales taxes;
- Property taxes;

- Value-added taxes (VAT); and
- Legalization of video lottery terminals.

The Commission examined each alternative as if each source alone would recoup the budget shortfall, and then examined hybrid options combining property and income taxes, property and sales taxes, and VAT and income taxes.

The Commission did not give an opinion as to which of the alternatives the Legislature should adopt. For each option, the study report discussed positive and negative aspects of the tax source, with evaluations of how each option fit with the tax principles and the effects on the economy and taxpayers. The Commission directed that the study report was intended to be used as a summary of various tax alternatives, but that each tax option would require further analysis before implementation.

Due to the reenactment of the statewide property tax measures in Chapter 338, Laws of 1999, the immediate pressure to fill the budget shortfall caused by the court decisions has been lessened. At this time, none of the additional tax alternatives proposed by the Commission have been enacted.

New Hampshire Commission on Education Funding – final report, ?
Claremont I (Claremont School District v. Governor, 138 N.H. 183)
Claremont II (Claremont School District v. Governor, 142 N.H. 462)
Chapter 17, New Hampshire Laws of 1999
Chapter 338, New Hampshire Laws of 1999

New Jersey State and Local Expenditure and Revenue Policy Commission

In December 1984, the New Jersey Legislature enacted Public Law 1984, Chapter 213, which established the State and Local Expenditure and Revenue Policy Commission and directed the group to systematically review the state and local tax structure.

The Commission was charged with evaluating the tax system in relation to the state and local expenditure structures and spending formulae. Particular attention was also directed on the tax system in relation to the following principles:

- State and local economic vitality;
- Taxpayer's ability to pay taxes and bear increased government spending costs;
- Adequacy of the tax system; and
- Reasonableness, efficiency and fairness of the tax system.

In July of 1988, the Commission presented its final report to the Governor and Legislature. The report included an in-depth analysis of the tax system and state fiscal policies and expenditures, identified major fiscal problems, and provided recommendations for reform. In its report, the Commission focused on the following two problems: over-reliance on services provided by local governments and unfair distribution of tax burdens based on taxpayer's ability to pay.

The Commission's recommendations focused on the objectives of expenditure reform, revenue reform, and long-term planning recommendations to safeguard the reform efforts. The following is a list of specific recommendations.

Expenditure Reforms:

- Reform local school financing systems to reduce disparities among districts;
- Define roles for state and local governments in regards to financing certain services, increasing the state role in financing certain "statewide" services; and
- Create a local tax equalization aid program to assist local governments in financing services.

Revenue Reforms:

- Expand the sales tax base;
- Expand the state gross income tax by widening the tax base and changing the rate structure;
- Increase the progressivity of the tax system overall by instituting a targeted property tax relief program;
- Centralize property tax administration; and
- Various reforms to public utility and business taxes.

Safeguarding Reforms:

- Implement programs to evaluate economic development programs and incentives;
- Implement budget reforms such as a rainy day fund, annual accounting of tax incentives, limits to dedicated taxes, and cost-sharing for state mandates to local governments.

The Commission analyzed the effects of the proposed reforms according to the principles mandated by the Legislature. The Commission determined that the overall effect of the reforms would be to create a more equitable distribution of property tax rates and revenues among local governments, and to impose less regressive tax burdens among households.

Few of the proposed reforms were actually implemented by the Legislature. In 1984 when the Commission was created, the state's economy was booming and both the Legislature and the Commission hoped that the recommendations of the group would be easily implemented. However, by 1988 and the completion of the report, the economy had taken a slight downturn and by 1989 the state was in the midst of a budget shortfall. Some of the administrative recommendations (such as the rainy day fund) were implemented, but none of the tax relief proposals were implemented.

Also, in the effort to achieve the goal of reducing local property tax burdens, the state implemented some reforms to transfer local taxing authority to the state, with the intention that the state would assume some of the financing burden for services. However, with the state's budget concerns, sharing of funds was increasingly difficult and local governments still rely heavily on local property taxes for revenues.

Recent Activities

In March of 2000, the New Jersey Legislature enacted a bill that created a Sales and Use Tax Review Commission. The purpose of the group is to review and report to the Legislature on proposed sales and use tax exemption legislation. The group is charged with reviewing proposed legislation according to the principles of equity, simplicity, economic neutrality, and cost efficiency. The group provides analysis of the fiscal impact of the proposed legislation and a brief policy discussion, and reports to the Legislature within 90 days of the introduction of the legislation.

New Jersey State and Local Expenditure and Revenue Policy Commission - final report - July, 1988

Oklahoma Revenue-Neutral Tax Reform

In April of 2001, Governor Frank Keating, Senate President Pro Tempore Stratton Taylor, and House Speaker Larry Adair formed an academic committee and charged the group with developing a tax reform program that accomplished the following goals:

- Eliminate the personal income tax;
- Eliminate the retail sales tax on groceries;
- Alter the Oklahoma estate tax to become a "pick up" tax; and
- Maintain revenue neutrality.

Unlike many other states that investigated tax reform options due to budget constraints or revenue shortfalls, Oklahoma's tax reform effort was driven by the predetermined policy goals of the three officials who requested the study. The study consisted of a search for new or expanded tax sources to replace the revenue that would be lost by implementing the above reforms. The committee developed revenue estimates for the tax reforms and the new tax sources.

The committee also considered lessons from other states when developing their recommendations. The group examined states with tax systems similar to their desired end results, namely: Florida, Nevada, Texas, and Washington, in the hopes that one of these states would demonstrate a successful alternative tax source.

The committee was charged with developing recommendations for replacement revenues. The committee presented five scenarios that represented a range of options for restructuring the tax system. Three of the scenarios relied on a single tax to fund the shortfall. The final two options are hybrid alternatives relying on multiple tax sources, making the relative increases in each tax source smaller than if each were relied upon exclusively. The options included:

- Property tax: Institute a state property tax (in addition to the existing local property taxes) and triple the tax rate.
- Sales tax: Expand the sales tax base to include many business service activities and increase the tax rate.
- Gross receipts tax: Impose a broad-based gross receipts business tax (similar to Washington's tax).
- Hybrid #1: Increase property tax rates, impose sales tax on services, and impose a low-rate gross receipts business tax.
- Hybrid #2: Increase property tax rates, and impose a gross receipts business tax.

The stated goal of the committee's report was to outline the alternatives and develop some background for making a policy choice, without endorsing a particular tax reform option. However, the committee did consider several tax principles when developing the alternatives and conducted a high-level analysis of the alternatives as they related to: revenue stability, tax exportation, economic efficiency, tax equity, and administrative simplicity. In the final conclusions, the committee indicated a preference for the hybrid scenarios with incremental changes to a variety of tax sources.

In the 2001 Legislative session, the Oklahoma legislature enacted HB 1933, a bill providing income tax relief in the form of an earned income tax credit. However, the legislation was enacted prior to the release of the Commission's final report. At this time, none of the wholesale tax reforms proposed by the Governor or the alternatives developed by the committee have been enacted.

Revenue-Neutral Tax Reform for Oklahoma – Issues and Options – final report, June, 2001

Tennessee
Tax Revision and Reform Act of 1999
And
Joint Select Committee on Business Taxes

In 1998, Governor Sundquist's budget proposal required approximately \$950 million more than the current tax system would support. In response, the 1999 legislature enacted a bill to reform and expand the state's franchise and excise taxes on businesses to alleviate some of the budget shortfall. The bill also required the Joint Select Committee on Business Taxes to evaluate the state tax structure, exemptions, and develop recommendations for alternative funding sources.

Prior to the enactment of Public Chapter (P.C.) 406, the state excise tax on business consisted of a 6 percent tax on the net earnings of corporations and cooperatives. The franchise tax was imposed on all taxpayers subject to the excise tax, in the amount of \$0.25 per \$100 of profits. The legislation made substantial expansions to the state franchise and excise taxes on businesses. The revisions included:

- Expanded the excise tax base to all for-profit businesses in the state, including various limited liability companies and partnerships;
- Expanded the franchise tax base to all for-profit businesses in the state;
- Expanded the franchise tax base to taxpayers' net worth (as opposed to profits);
- Raises the minimum amount of franchise tax paid by taxpayers to \$100 (originally \$10 minimum);
- Requires quarterly estimated payments for both taxes for taxpayers with tax liability over \$5,000 annually; and
- Transfers collection and administration responsibilities to the State Commissioner of Revenue for the local option sales taxes imposed by cities and counties.

In addition to the tax revisions mentioned above, P.C. 406 also required the state Joint Select Committee on Business Taxes (the Committee) to evaluate all statutory tax exemptions causing state revenue losses over \$1,000,000 per year. The legislation included additional provisions to:

- Require the Committee to review all current statutory exemptions to determine whether they are serving a valid state purpose;
- Require the Committee to draft and introduce legislation to amend or repeal an exemption if so decided by the Committee;
- Established a four-year schedule for evaluating the current statutory exemptions;
- Established a four-year automatic sunset date for exemptions enacted after January 1, 2000.

The Committee was also directed to evaluate the state's tax system in general. In August of 1999, the Committee initiated a series of public meetings to solicit testimony regarding the tax study. In October of 1999, the Committee issued a final report outlining the results of the Committee's evaluation of the tax system. The group did not reach conclusions about recommendations for alternative funding sources, but made the following findings:

- The state's current revenue system is inadequate and suffers from "structural flaws;"
- The state should develop a "vision of the future," which would include the key strengths of the state;
- The state should develop a set of goals which would achieve the state vision; and
- The state should develop a revenue system that adheres to basic tax principles and would assist in achieving the goals and vision.

In the Committee's final report, the group included drafts of each of the above findings, in which the importance of fully funding state education programs emerged as a key theme in both the state vision and state goals. The Committee did not develop any recommendations for alternative funding sources to implement any substantial tax reform to achieve the above goals.

In addition to the tax reform efforts enacted in P.C. 406 and outlined above, various legislative proposals have been floated to enact a state personal income tax. Although the state currently imposes a tax on interest and dividends income, it does not impose a tax on salaries and wages. None of the proposals have passed the legislature, however.

Joint Select Committee on Business Taxes – Final Report, October 21, 1999
Public Chapter 406, Laws of 1999